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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of

Federal-State Joint Board on
Universal Service

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CC Docket No. 96-45

COMMENTS ON THE UNIVERSAL SERVICE RECOMMENDED DECISION

BELLSOUTH CORPORATION
BELLSOUTH TELECOMMUNICATIONS, INC.

M. Robert Sutherland
Richard M. Sbaratta
Rebecca M. Lough

Their Attorneys

Suite 1700
1155 Peachtree Street, N.E.
Atlanta, Georgia 30309-3610
(404) 249-3386

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TABLE OF CONTENTS

SUMMARY.....	i
I. INTRODUCTION.....	1
II. GENERAL OBSERVATIONS.....	3
III. COMPETITIVE NEUTRALITY	7
A. Obligation To Contribute.....	9
B. Opportunity To Recover Contributions.	14
C. Consistency Among Rules And Regulations.	16
IV. LOW INCOME	17
V. SCHOOLS AND LIBRARIES	19
A. Services, Functionalities And Equipment Included As Eligible For Universal Service Support.	19
1. The Act Limits USF Support Recipients To “Telecommunications Carriers.”.....	20
2. The Act Limits Services Which Are Eligible For Universal Service Support To Telecommunications Services.....	22
3. Information Service Providers And Providers Of Internal Connections Are Not Eligible To Receive USF Support.	25
B. Discount Methodology.	29
1. The Requirement For Competitive Bids.	29
2. The Pre-Discount Price.....	31
3. Discounts From The LCP.	34
a. Amount Of The Discount.....	34
b. Cap On USF And Trigger Mechanism.....	35
c. Schools And Libraries In High Cost Areas.	37

d. Existing Special Rates.....	37
4. Administrative Details.....	38
C. Restrictions On Schools And Libraries.....	38
VI. HEALTH CARE PROVIDERS.....	40
VII. CONCLUSION.....	46

SUMMARY

The Recommended Decision describes the framework of an approach to establishing a federal universal service fund. Many of the essential details remain undefined and require further development by the Commission. The Public Notice is a first step in the development process. It solicits comments on five areas: (1) competitive neutrality as a universal service principle; (2) the low income and Lifeline modifications; (3) support for schools and libraries; (4) support for rural health care providers; and (5) administration, particularly the revenue base for determining contributions to the fund.

Section 254 requires that the Commission establish a federal universal service fund that replaces the current implicit support approach with an explicit support mechanism. The explicit mechanism must enable local exchange carriers to recover the costs it has legitimately incurred to provide universal service. Key elements of the Joint Board's proposal, which bear upon the sufficiency of the fund, remain unknown. For example, the revenue benchmark which will be used to demark the federal responsibility for universal service support is undefined but is nonetheless crucial to determining the size of the fund. In order to minimize the potential for misspecification, BellSouth believes a benchmark based on affordability (i.e., 1 % of household income) would be a superior benchmark and more in line with the requirements of Section 254. Likewise, the benchmark should be calculated on a disaggregated basis such as a county, rather than on a nationwide basis. A disaggregate measure would likely be more consistent with the universal service areas that the state commissions will designate.

An equally important, but undefined, component of the Joint Board's proposal is the cost proxy model. If the model does not adequately represent the actual costs incurred to provide

universal service, the fund will be insufficient, and, hence, inconsistent with the mandate of Section 254.

COMPETITIVE NEUTRALITY

BellSouth supports the Joint Board's proposal to adopt competitive neutrality as an additional principle upon which to base universal service policies. In the context of universal service support, competitive neutrality can be viewed as having three dimensions, all of which must be considered explicitly if the principle is to be satisfied. The dimensions are: (1) competitive neutrality in the obligation to contribute to the fund; (2) competitive neutrality in the opportunity to recover support obligations; and (3) consistency between universal service support and other regulations.

In addition to the contribution mechanism being equitable and nondiscriminatory, competitive neutrality requires that no contributing carrier or class of carriers be advantaged or disadvantaged by the contribution mechanism established by the Commission. At the outset, the basis for determining a carrier's contribution that is most consistent with this principle is one which uses both intrastate and interstate revenues. As explained in the comments, the inability to precisely identify the jurisdiction of traffic would subject a contribution mechanism based on the revenue from a single jurisdiction to potential manipulation by creating incentives to misclassify revenues. Some carriers could reduce their contributions to the universal service fund to the detriment of other carriers. The potential for such competitive tampering could not be reconciled with competitive neutrality.

Equally important to the revenue base is the measure of revenues used in the contribution mechanism. Contrary to the Joint Board's recommendation, the measure of revenue that is

consistent with the principle of competitive neutrality and the express requirements of the Act is retail revenue. Because the obligation to contribute only arises through the provision of telecommunications service, the measure of revenues should be those revenues derived from the provision of such services--i.e., retail revenues.

The contributions that interstate carriers make to the universal service fund represent a cost of doing business. As such, the carriers must recover these costs as they do any other cost if they are to remain in business. Existing regulatory asymmetry, however, can hinder a carrier or class of carriers from having an opportunity to recover their costs on the same basis as other contributors who are also competitors. The best approach to recovery is for the Commission to fix the recovery mechanism by establishing an end user surcharge to be applied in a similar manner by all contributing carriers. A mandatory surcharge would be consistent with the principle of competitive neutrality because the contributions of all carriers would be recovered in precisely the same manner.

Implementation of Section 254 cannot be considered in isolation and achieve competitive neutrality. Seemingly neutral universal service rules can, in fact, be put out of balance because of the effect of other rules. Accordingly, the Commission must remain mindful of the existing and potential interrelationships. As implementation moves forward and the rules evolve, the Commission must be prepared to make adjustments, where necessary, to insure that the intent of the Commission's rules is realized.

LOW INCOME

The low income recommendations of the Joint Board appear to have lost sight of the division of responsibility between the state and federal jurisdictions that is contained in Section

254. The appropriate federal baseline amount for Lifeline support should be set at the interstate charges paid by end users. At present, it is the subscriber line charge. In the event the Commission adopts an end user surcharge as a recovery mechanism for universal service contributions, then such surcharges could also be included in the baseline amount.

SCHOOLS AND LIBRARIES

With regard to the education portion of the universal service fund program, and, in particular, the types of services eligible for support, BellSouth supports the Commission's view that telecommunications services beyond those eligible for universal service core support are eligible for support under Section 254(h). However, the Commission should not adopt the Joint Board's recommendation that non-telecommunications carriers and services be included. The Act limits the recipients of such support to telecommunications carriers in connection with the provision of telecommunications services, and the Commission's final rules must be consistent with such requirements.

With regard to the discount methodology, the capped fund, and the trigger mechanism recommended by the Joint Board, BellSouth generally supports such recommendations. However, there are many issues which remain to be resolved and/or clarified, and details to be formulated. For instance, in determining the LCP for a given service bid, a carrier should be permitted to take into consideration the full range of factors commonly utilized to determine the prices of services in its LCP consideration. While BellSouth supports the use of appropriate criteria such as the school lunch program for determining the discounts applicable to a given school or library, it also would support an additional measure beyond that suggested by the Joint Board to assure that schools and libraries in high cost areas facing exceptional circumstances

could obtain special support. In addition, while BellSouth supports the concept of consortia, the Commission should look carefully at whether the market power which can be exerted by such combined entities is sufficient to meet the needs of schools and libraries for low-priced service arrangements without involving the difficult issues surrounding the application and administration of discounts to multiple entities for a single service which could be involved if consortia are included in the universal service fund program.

HEALTH CARE PROVIDERS

BellSouth understands the Commission's need for additional information in connection with the Act's requirements under Section 254(h)(1)(A) regarding rural health care providers. At the same time, the questions set forth in the Commission's Public Notice regarding this section reflect a misfocus by the Commission. As BellSouth discusses further below, the Commission must recognize that Section 254(h)(1)(A) provides USF support only for "necessary" telecommunications services; that the carrier is only obligated to provide such services at "rates" comparable to urban rates, not at comparable billed amounts; and that any requirement that USF support be provided for network build-outs is of questionable need and legality.

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COMMENTS ON THE UNIVERSAL SERVICE RECOMMENDED DECISION

BellSouth Corporation and BellSouth Telecommunications Inc. ("BellSouth") hereby submit their comments in response to the Public Notice, DA 96-1891, released on November 18, 1996.

I. INTRODUCTION

Section 254 of the Telecommunications Act of 1996 (the "Act")¹ mandated the establishment of a Federal-State Joint Board to recommend a new set of universal service support mechanisms that are explicit and sufficient to advance the universal service principles enumerated in the statute. On November 8, 1996, the Joint Board released its Recommended Decision which proposes a new framework for preserving universal service.²

Under the Act, the Commission has six months from the Joint Board's Recommended Decision to promulgate implementing rules.³ There are numerous aspects of the Recommended

¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 as codified in 47 U.S.C. Section 151 *et. seq.* Hereinafter, citations to the Telecommunications Act (or Act) will be to the relevant sections of the United States Code.

² In the Matter of Federal State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision (FCC 96J-3), released November 8, 1996. ("Recommended Decision" or "Order")

³ 47 U.S.C. Section 254(a)(2).

Decision wherein the Joint Board made no specific recommendations and suggested the Commission obtain additional comments. In its Public Notice, the Commission solicits comments regarding five specific areas: (1) competitive neutrality as a universal service principle; (2) the low income and Lifeline modifications; (3) support for schools and libraries; (4) support for rural health care providers; and (5) administration, in particular the revenue base for determining contributions to the fund.⁴ In addition to these specific topics, the Public Notice also invites parties to comment on the Joint Board's recommendations.

Section 254 requires a new and more exacting approach toward universal service support than has been the case in the past. The Recommended Decision creates the framework of an approach that remains to be filled out through further evolution of implementation details, some of which are raised by the Public Notice. With many key elements of the universal service mechanism undefined, particularly the size and sufficiency of the fund, the Commission must consider these additional comments as tentative, subject to revision as other details of the support mechanism unfold.⁵

⁴ In these comments, BellSouth addresses the appropriate basis for assessing contributions in Section III(A).

⁵ During the initial comment and reply comment phase of this proceeding, parties proposed approaches whose elements worked together to achieve the Act's objectives. Here, the Commission seeks comments on specific topics associated with universal service support. In order to provide these comments, parties must make certain assumptions about the size and distribution of universal service support. If these assumptions are invalidated by future Commission action, then the positions articulated in these comments may require modification in light of such action.

II. GENERAL OBSERVATIONS

Once implemented, the universal service support mechanism will be the source of a federal fund which is supposed to displace implicit sources of support with a fund that is “explicit and sufficient to achieve the purposes” of the Act.⁶ As a federal fund, the support should be used to remove the implicit support currently reflected in interstate rates. For local exchange carriers (“LECs”), these subsidies have come about as a result of the jurisdictional separations process and have been embedded in interstate access charges. A portion of the cost of virtually every function of the exchange network that has been included within the definition of universal service has been allocated to the interstate jurisdiction through the jurisdictional separations process. Hence, it is appropriate to reduce interstate access charges in an amount equal to the net amount of federal universal service support received by a LEC.

Interstate rate reductions could first be accomplished by reducing interstate carrier common line charges. Carrier common line charges have been used as a means of shifting cost recovery from end users to interstate access customers. They represent a carry-over to the post-divestiture environment of the mechanism of supporting local rates through interstate toll charges.⁷ In addition to carrier common line charge reductions, universal service support could also be used to reduce the interstate interconnection charge. As BellSouth explained in its initial

⁶ 47 U.S.C. Section 254(e).

⁷ If the support received from the universal service fund is insufficient to reduce the carrier common line charge to zero, then the Commission must address the recovery of the remaining carrier common line amounts in its access charge reform proceeding. As the Joint Board correctly observed, usage-sensitive charges are an inefficient recovery mechanism that must be replaced. Order at para. 775. In the access charge reform proceeding, the usage sensitive carrier common line charges should be replaced with bulk-billed, non-usage sensitive recovery mechanism.

comments, the interconnection charge, in large part, reflects the support that dedicated interstate transport has provided to the local trunking component of universal service.⁸

While carrier common line and interconnection charges represent the predominate sources of implicit support for universal service that are embedded in a LEC's interstate service rates, traffic sensitive switching charges also reflect an interstate allocation of costs through the jurisdictional separations process that have reduced intrastate local exchange switching costs. Absent this allocation, the costs would have to be recovered through rates charged to end users for local exchange services. The Joint Board has recommended a definition of universal service that encompasses local usage and, thus, the switching function. To the extent that the federal fund is sufficient in size, reduction of interstate traffic-sensitive switched access charges would be an appropriate offset.

The procedures for effectuating the appropriate interstate offsets are matters that should be addressed in the access charge reform proceeding. The concern for the Commission in the instant proceeding is to establish the standard that the implicit support reflected in interstate access charges be adjusted by the net amount received by a LEC from the federal fund.⁹ Such a

⁸ See BellSouth's Comments filed on April 12, 1996 in CC Docket 96-45, pp. 8-9. BellSouth expects that the Commission, in its access charge reform proceeding, will permit LECs to adjust the interconnection element by realigning certain costs, such as tandem switching, with other access elements. It is the interconnection amount that remains after this realignment that would be offset by universal service support.

⁹ Section 254 requires that implicit support be identified and recovered through an explicit mechanism. The statute does not condone increasing implicit support. Nevertheless, the Joint Board recommends (para. 759) that interstate subscriber line charges should be reduced to reflect the recovery of payphone CPE and long term support from sources other than interstate carrier common line charges. Any such reduction in subscriber line charges would be tantamount to increasing implicit support and would be completely contrary to Section 254. Accordingly, the (Continued...)

standard is consistent with the Act's requirement that the support be explicit and that the support be used for the purposes intended by the Joint Board.¹⁰

Moreover, if the Commission's implementing rules specifically recognize that the federal fund provides the means to address implicit support contained in interstate rates, such as access charges, such a recognition would complement the statutory authority given to the states to establish state specific universal service support mechanisms that are consistent with the federal mechanism.¹¹

The statutory goal of preserving and advancing universal service is best accomplished with a clear delineation of responsibility between the state and federal jurisdictions. The Recommended Decision articulates the concepts for this delineation which the Commission must put into action in the rules it adopts.

In particular, the Recommended Decision establishes the mechanism for clearly demarking federal and state responsibility for universal service support--the revenue benchmark.¹² The federal fund will support universal service only to the extent that the proxy cost exceeds the revenue benchmark. The point that should not be overlooked and, indeed, should be stressed by the Commission is that the proposed revenue benchmark is not an attempt to measure affordability or subsidy free charges.¹³ The revenue benchmark may be based on intrastate rates

recommendation should be rejected, or, at a minimum, any reduction in subscriber line charges should be recovered through the explicit universal service fund.

¹⁰ 47 U.S.C. Section 254(e).

¹¹ 47 U.S.C. Section 254(f).

¹² Recommended Decision at paras. 299.

¹³ BellSouth urges the Commission to reject the revenue benchmark and adopt an affordability benchmark such as 1% of household income. The affordability benchmark should be measured on (Continued...)

that have implicit universal service support embedded in the rates.¹⁴ The difference between the benchmark rate and the affordable rate (as determined by the state commission) is implicit support for which the state remains responsible. Thus, if the federal fund does not remedy all of the implicit support, then state commissions would be responsible for establishing state universal service mechanisms that make explicit the amount of implicit support not addressed in the federal fund.¹⁵

Another, and equally important, consideration is the determination of universal service costs. The Joint Board recommends a proxy cost model be developed for the purposes of implementing universal service support.¹⁶ Because the model is unspecified, it is impossible to determine the sufficiency of the support that the universal service fund will provide.¹⁷ While the Joint Board may perceive forward-looking economic costs as an approximation of costs that would be incurred by an efficient competitor entering the market, the Joint Board is incorrect to the extent it views actual costs that incumbent LECs have incurred to provide universal service as costs of an inefficient provider. All of these costs have been the subject of regulatory oversight,

a county basis. Even if the Commission is committed to a nationwide benchmark, it should still be based on an affordability measure.

¹⁴ If the Commission does not adopt an affordability measure as a benchmark, then BellSouth believes that the revenue benchmark should only include the revenues derived from services which the Commission includes within the definition of universal service. In this regard, the only appropriate access revenue to be reflected in the benchmark rate is that associated with the subscriber line charge.

¹⁵ The objective must be to eliminate implicit support. To the extent that actual rates are below the benchmark, the state commissions would be responsible for establishing a universal service support mechanism to address this difference.

¹⁶ Order at para. 269.

¹⁷ The LEC industry is in the process of developing a model which incorporates the best features of the BCM2 and CPM models. This effort should be completed in early January 1997 and would be available for the Commission's consideration in this proceeding.

and, to some extent, resulted from meeting specific regulatory requirements. These incurred costs are legitimate and reasonable costs of providing universal service and the incumbent LECs have a constitutional right to recover these costs.

Further, to the extent that actual costs of providing universal service are not recovered through the rates and charges for this service, then these costs are currently recovered through the rates of other LEC-provided services, including interstate access. Thus, these other LEC services are providing the implicit support to universal service that the new universal service fund is to address. Indeed, Section 254 directs the Commission to make universal service support explicit and sufficient.¹⁸ If the proxy cost model fails to account for the existing implicit support, then the Joint Board's recommendation will not satisfy the statute's mandate and, therefore, the recommendation cannot lawfully be adopted by the Commission.

III. COMPETITIVE NEUTRALITY

The Joint Board recommends that the Commission establish competitive neutrality as an additional principle to be considered in adopting policies for the preservation and advancement of universal service.¹⁹ The Act enumerates seven principles upon which the Joint Board and Commission are required to base their universal service policies. The Act permits the Commission to consider other principles that it and the Joint Board “determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent” with the Act.²⁰ An overarching purpose of the Act is to promote telecommunications competition. With

¹⁸ See 47 U.S.C. Section 254(e).

¹⁹ Order at para. 23.

²⁰ 47 U.S.C. Section 254(b).

respect to universal service, the Act specifically contemplates competition. Section 214(e) anticipates local exchange competition and provides for multiple carriers as being eligible²¹ to receive universal service support.²² As the Joint Board concluded, “competitively neutral collection and distribution of funds and determination of eligibility in the universal service support mechanism is consistent with congressional intent ‘to provide for a pro-competitive, deregulatory national policy framework.’”²³ Thus, the Joint Board is correct in its conclusion that competitive neutrality encompasses concepts beyond the express requirements of the Act, but which nonetheless foster the goals and objectives of the Act.

²¹ 47 U.S.C. Section 214(e). While the Recommended Decision (para. 156) does not suggest that the Commission adopt any additional federal criteria for becoming an eligible carrier other than that specified in Section 214(e)(1), it proceeded upon the belief that the common carrier obligation should prevent “cherry picking” and other selective targeting that would be inconsistent with the principles of universal service. The Commission should, nonetheless, clarify that an eligible carrier’s obligation to hold itself out to serve the public means that it must do so on a nondiscriminatory basis. Thus, an eligible carrier may not discriminate among customers in offering universal service nor may it provide some customers with undue preferences in terms of installation intervals, service quality, maintenance, or other provisioning activities. Further, the universal service rules should make clear that any eligible carrier must establish a distinct price for its universal service before it can be eligible for support. A carrier that could be eligible for universal service support could also provide, on an integrated (packaged) basis, other services including non-telecommunications services such as cable television. A distinct price for universal service would ensure that the support is being used for the purposes intended as required by the statute. See 47 U.S.C. Section 254(e). Such clarifications would be consistent with and facilitate the achievement of competitive neutrality.

²² The Recommended Decision (para. 161) makes clear that carriers providing service exclusively through resale may not be deemed eligible carriers. Implicit in the Recommended Decision is that in a resale situation, the underlying facilities-based carrier would be the recipient of the universal service support. Accordingly, the Commission should, in its implementing rules, clarify that anytime resale is involved, the underlying facilities-based carrier should receive the support associated with the resold service.

²³ Order at para. 23.

The Joint Board suggests the Commission adopt as a statement of principle that universal service support mechanisms and rules should be applied in a competitively neutral manner.²⁴ In the Public Notice, the Commission seeks comments on the definition of competitive neutrality and how it should be applied. This request evidences an understanding by the Commission that in order for this principle to be of practical consequence, the dimensions of competitive neutrality must be fully understood.

In the context of universal service support, competitive neutrality can be viewed as having three dimensions, all of which must be explicitly considered as the implementation details of the support mechanism unfold, if the principle is to be satisfied. The dimensions are: (1) competitive neutrality in the obligation to contribute to the fund; (2) competitive neutrality in the opportunity to recover support obligations; and (3) consistency between universal service support and other regulations. Each of these will be discussed.

A. Obligation To Contribute.

One of the principles upon which universal service policies is to be based is that providers of telecommunications services should make equitable and nondiscriminatory contributions to the universal service fund. While this principle is a necessary condition of competitive neutrality, it is not a sufficient condition. Competitive neutrality also requires that no contributing carrier or class of contributing carriers should be advantaged or disadvantaged by the contribution mechanism established by the Commission.

An open issue is the base upon which to determine a contributing carrier's universal service obligation. The principle of competitive neutrality supports the use of a contributing

²⁴ Id.

carrier's combined interstate and intrastate revenues as the basis of determining the carrier's contribution.²⁵ To use interstate revenues exclusively presumes that such revenues can be precisely identified, measured and recorded. The presumption is incorrect. There are many circumstances wherein the jurisdiction of the service cannot be determined by the call but instead is determined by a customer's declaration or reporting. The most well known example is associated with the jurisdiction of private line and special access services. Here the jurisdiction of the service falls within one jurisdiction or the other solely on the basis of the customer's statement as to intended use. Because a customer's choice of jurisdiction could effect a carrier's contribution to universal service support, there would be an incentive for carriers to direct customers toward intrastate services in order to reduce the carrier's contribution.²⁶

The inability to precisely determine jurisdiction is not confined to dedicated services. Even switched services are subject to jurisdictional manipulation. For example, the jurisdiction of a call cannot be identified for services which use Feature Group A switched access.

²⁵ Section 254 directs that every telecommunications carrier that provides interstate telecommunications service shall contribute to the federal universal service fund on an equitable and nondiscriminatory basis. The Joint Board recognizes that the qualities of equitable and nondiscriminatory are subsumed within the principle of competitive neutrality. Thus, if the Commission finds that the use of both intrastate and interstate retail revenues satisfies competitive neutrality, then it is within the Commission's statutory authority to use interstate and intrastate revenues as the basis of contribution to the universal service fund.

²⁶ The incentive to misreport jurisdiction is doubled in the event the Commission decides to include access revenues as part of the revenue base upon which to determine universal service obligations. An access customer would have the incentive to declare an access service as jurisdictionally interstate to increase an access provider's contribution to the federal fund, while at the same time it would have the incentive to classify as much of its retail services as possible as intrastate to reduce its own contribution.

Jurisdictional imprecision is not a circumstance that is likely to improve. To the contrary, new network technologies and multiple carrier call handling will further obscure the jurisdiction of the call. Whereas originating and terminating telephone numbers are currently the primary means of identifying the jurisdiction of the call, with the advent of personal numbering services, telephone numbers will have no jurisdictional meaning.

A contribution mechanism that is based solely on the revenues of a single jurisdiction creates an incentive for tampering for competitive purposes. It would enable some carriers to reduce their contributions to the universal service fund to the detriment of other carriers who are likely competitors. Because universal service contributions represent a cost to a carrier, a mechanism that is subject to manipulation distorts the competitive marketplace and would be inconsistent with the principle of competitive neutrality. Accordingly, a contribution mechanism that is based on both interstate and intrastate revenues should be adopted.

Another factor to be considered in establishing the contribution mechanism is the measure of revenues to be used. The Recommended Decision advocates the use of gross revenues less payments to other carriers.²⁷ This recommendation, however, is lacking for several reasons. First, regardless of the revenue measure (e.g., gross revenues, retail revenues), payments to other carriers should not be deducted. Such deductions are not competitively neutral. To the contrary, they would create competitive distortions. For example, if one carrier provides a service using its own network, the network facilities represent a cost of service that is recovered through the carrier's rates and charges. The total revenues received from these services would be used to determine the carrier's contribution. If a second carrier provides the same service through

²⁷ Order at paras. 807, 809.

facilities obtained from another carrier, the payments to the owner of the facilities also represent a cost of providing service. Yet, under the Recommended Decision, the second carrier could deduct these payments prior to determining its contribution to the universal service fund whereas the first carrier has no comparable offset for its cost of providing service.

This result can hardly be considered competitively neutral. It confers a cost advantage upon carriers that lease facilities from other carriers and discourages facilities-based local competition. The competitive consequences extend beyond traditional landline carriers. They would also affect technology deployment, particularly new wireless technologies. While the Recommended Decision strives to be technologically neutral so as not to disadvantage one technology over another, the recommended contribution mechanism is, in fact, biased technologically and favors services that are provided over existing leased facilities. These competitively distortive effects can be avoided if there are no deductions for payments to other carriers.

The revenue measure, itself, is as important to achieving competitive neutrality as is the issue of adjustments. The most common denominator among interstate carriers is retail revenues. It also represents the measure of revenues most consistent with the Act's express requirements.²⁸ Section 254 (d) provides that every telecommunications carrier that provides interstate telecommunications service shall contribute to the fund.²⁹ Telecommunications service is defined

²⁸ The principles upon which universal service policies are to be based, including the additional principle of competitive neutrality, are circumscribed by the express requirements of the Act. Thus, the principles should be applied in a manner consonant with Section 254's specific provisions.

²⁹ 47 U.S.C. Section 254 (d).

as “the offering of telecommunications for a fee directly to the public....”³⁰ Because the obligation to contribute only arises through the provision of telecommunications service, then the measure of revenues should be those revenues derived from the provision of such services--i.e., retail revenues.³¹

Use of retail revenues would enable the Commission to ensure that the contribution mechanism is equitable and nondiscriminatory because such measure can accommodate the fact that not all carriers serve the same markets. This measure does not distort the competitive conditions within these various markets. Hence, the use of retail revenues is not only consistent with the equitable and nondiscriminatory contribution basis mandated by the Act,³² but also satisfies the principle of competitive neutrality unlike any other measure of revenue.

The principle of competitive neutrality, to be properly applied, requires a Commission rule that identifies combined intrastate and interstate retail revenues as the contribution measure. Such

³⁰ 47 U.S.C. Section 153 (46). The Act differentiates a telecommunications carrier from the public by defining a telecommunications carrier as a provider of telecommunications service. 47 U.S.C. Section 153 (44).

³¹ If gross telecommunications revenues were used as the measure for determining contributions, such measure would distort the competitive marketplace in that carriers who derive telecommunications revenues from providing both retail telecommunications services and facilities to other carriers would have both sources of revenues included in determining their contribution to universal service. On the other hand, the Act only subjects interstate carriers who provide telecommunications service to contributing to the universal service fund. Hence, carriers who do not provide telecommunications services to the public for a fee would be excluded from contributing to the fund. As such, they gain a competitive advantage over the multiproduct carriers providing both telecommunications services and facilities and network capabilities to other carriers. Likewise, these multiproduct carriers are also disadvantaged relative to those carriers that only provide retail services. A gross revenue measure advantages the retail provider because the revenue base of the multiproduct provider is broader and reduces the relative contribution of the retail provider.

³² See 47 U.S.C Section 254 (d).

an implementing rule, because it supports a principle of universal service adopted by the Commission, would likewise have to be followed by the states to the extent that they establish state universal service funds (i.e., contributions to any state fund should be based on intrastate and interstate revenues). Any other approach would result in a state fund being inconsistent with the Commission's rules and, thus, in violation of Section 254 (h) of the Act.³³

B. Opportunity To Recover Contributions.

The contributions that interstate carriers make to the universal service fund represent a cost of doing business. As such, the carriers must recover these costs as they do any other cost if they are to remain in business. In the past, support for universal service has typically been built into rates of services provided by the LECs. The new universal service fund mechanism is supposed to identify the implicit support embedded in these rates and distribute the support *obligation among interstate carriers that provide telecommunications services.*

These carriers' contributions, like other costs of providing service, will be passed on to consumers of the telecommunications services. The opportunity to recover costs is unassailable. Absent such recovery, the carrier will go out of business.

Existing regulatory asymmetry, however, can hinder a carrier or class of carriers from having an opportunity to recover their costs on the same basis as other contributors who are actual or potential competitors. The resulting detriment is not merely to the carrier, but rather operates as an impediment to satisfying the principle of competitive neutrality. Competitive neutrality requires that all carriers be afforded the same opportunity to recover their contributions to universal service support. In application, it means that all contributors should enjoy the same

³³ 47 U.S.C. Section 254 (h).

flexibility to establish prices and rate structures to recover their universal service contributions. Hence, the Commission should adopt a rule that establishes an opportunity to recover universal service contributions on an equal basis among carriers and declare any regulation that is inconsistent with this rule as unenforceable.

While the approach to recovering support obligations could be left to the carrier contributors to determine, the best approach to recovery is for the Commission to fix the recovery mechanism by establishing an end user surcharge to be applied in a similar manner by all contributing carriers.³⁴ Without a surcharge, the prices of telecommunications services would have to be increased to compensate carriers for their contributions to the fund. Such an approach, however, does not consider the fact that not all carriers are able to unilaterally adjust their service prices. Some carriers face regulatory impediments. Others have long term contracts with their customers whose terms preclude price adjustments. A surcharge mechanism obviates these difficulties and provides an explicit means for funding universal service support. As such, the surcharge is clearly consistent with the objectives of Section 254 of the Act.

Employing an end user surcharge for recovery of the universal service fund obligations would be a means of spreading the recovery burden equitably without causing significant distortions in telecommunications service prices. Further, a mandatory surcharge would be consistent with the principle of competitive neutrality because the contributions of all carriers would be recovered in precisely the same manner, with no carrier being advantaged or

³⁴ The California Public Utilities Commission recently adopted such an approach for a carrier to recover its contribution to the state universal service fund. See Rulemaking on the Commission's Own Motion Into Universal Service and To Comply With the Mandates of Assembly Bill 3643, R.95-01-020 and Investigation on the Commission's Own Motion Into Universal Service and To Comply with the Mandates of Assembly Bill 3643, I.95-01-021, Decision 96-10-066.

disadvantaged because of its obligation to contribute or in the way such contributions are recovered.

Further, the end user surcharge would have the additional salutary benefits of being simple to calculate and easy to administer. Each carrier would divide its universal service contribution by its retail revenues. The resulting percentage would then be applied to each customer's retail charges to determine the surcharge.

C. Consistency Among Rules And Regulations.

In determining the rules necessary to meet the principles and requirements of Section 254, the Commission must also be mindful of other rules and regulations that may affect the achievement of the universal service objectives or, indeed, conflict with these objectives. Numerous, new regulations are being promulgated by both this Commission and state commissions as a result of the Telecommunications Act of 1996. In addition, many existing regulations govern the way in which local exchange carriers may do business. During the course of this proceeding, the focus has been to identify the additional regulations that would be needed to implement the requirements of Section 254. No consideration has been given to the relationship of these rules to other rules and regulations.

Implementation of Section 254 cannot be considered in isolation and achieve competitive neutrality. Seemingly neutral universal service rules can, in fact, be put out of balance because of the effect of other rules. For example, universal service support will be available to multiple eligible carriers for a service area to be determined by the state commissions. At the same time, carriers that are potential recipients of the universal service support may also obtain unbundled network elements as part of the network facilities used to meet their universal service obligations.

To the extent that the prices of the unbundled elements are based on costs associated with a different geographical area than the geographic area that is used to determine universal service support, there is a potential that this inconsistency creates arbitrage opportunities for new entrants (i.e., making universal service a profitable line of business) and putting incumbent LECs at a competitive disadvantage.

Accordingly, the Commission must remain mindful of the existing and potential interrelationships. As implementation moves forward and the rules evolve, the Commission must be prepared to make adjustments, where necessary, to insure that the intent of the Commission's rules is realized in practice.

Likewise, effectuation of the competitive neutrality principle requires that this Commission and the state commissions be prepared to alter existing regulations to comport with the universal service support program. For example, access charge reform is a necessity. The limitations and constraints on rate structure and pricing mandated by the Part 69 rules are inefficient and place incumbent LECs at a competitive disadvantage vis-a-vis their competitors with respect to recovery of their interstate universal service obligations. The disadvantage would be compounded with the implementation of the Recommended Decision unless the access charge rules were modified in a manner consistent with competitive neutrality.

IV. LOW INCOME

The Public Notice solicits comments regarding the Recommended Decision's low income (Lifeline) support proposals. The Recommended Decision proposes an interstate Lifeline amount of \$5.25 without any matching state Lifeline programs.³⁵ The Commission seeks comment on the

³⁵ Order at para. 419.